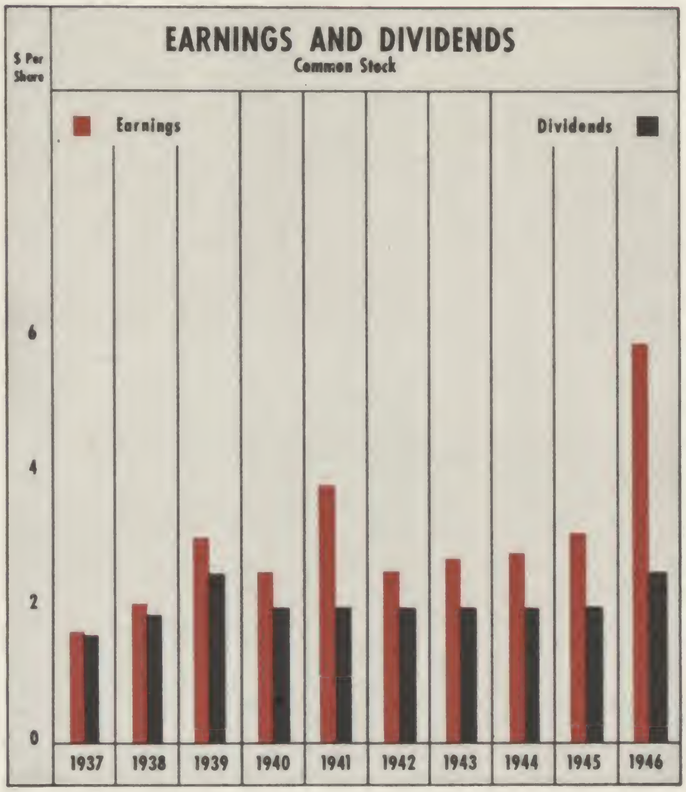
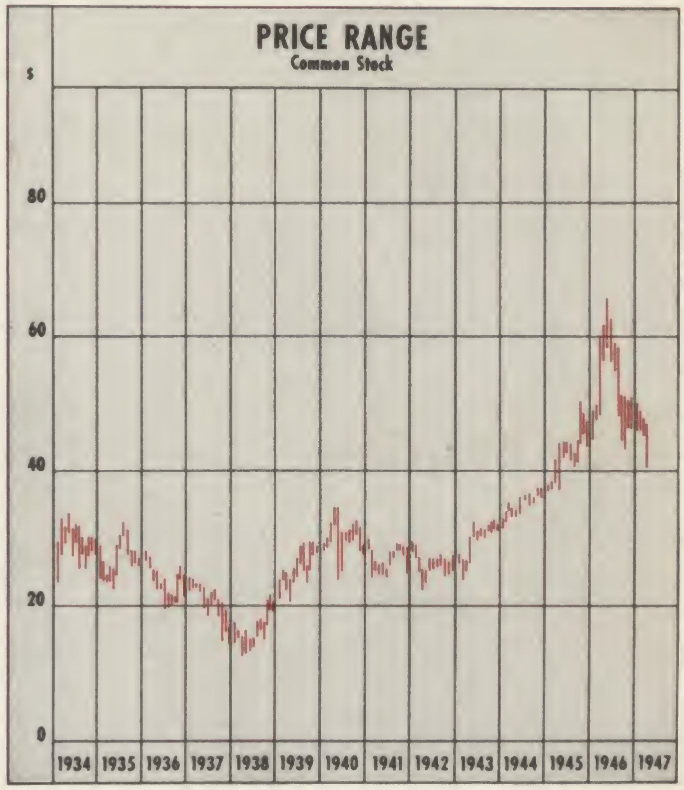
1947 EDITION

THE KROGER CO.





TIMING . . . For every investor, sound investment procedure requires a series of separate but related decisions in each of which "risks and rewards" must be weighed. Of these decisions, all investment experience proves that "when to buy" ranks equally in importance with "what to buy." Similarly, the alert investor will recognize that there is no security which can be "bought and forgotten" and that successful investment requires keen judgment in timing sales as well as purchases.

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Underwriters and Distributors of Investment Securities
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THE KROGER CO.

FAVORABLE

(1) Kroger's retail outlets are located in territory of high economic vitality.

(2) Attitudes of management toward development of the company are more aggressive than was the case some years ago.

(3) Financial resources are substantial among food retailing chains and net quick assets provide the major portion of net book value for the common stock.

(4) In point of sales and earnings expansion during the war years, Kroger was among the leaders of the chain food retailing group.

(5) Chain food retailers may be expected to regain a higher proportion of total food sales under the more competitive conditions of peacetime. Kroger itself has a substantial program in development for improving retailing units and increasing efficiency of operations.

UNFAVORABLE

(1) Current sales volumes for food store chains reflect abnormally high selling prices for foods. A decline to lower prices could entail a substantial squeeze between reduced gross profits and less flexible operating costs.

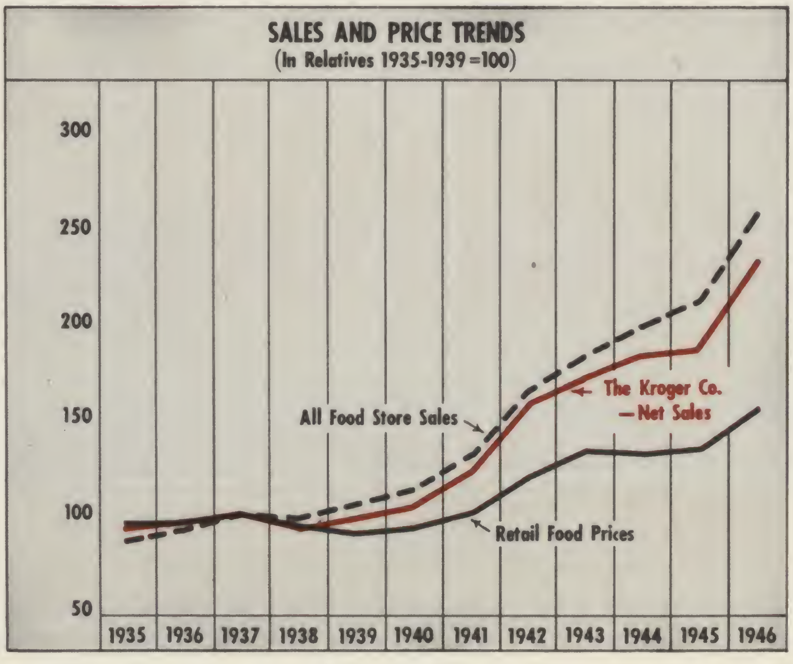
(2) Despite stable tonnage demand for food, current extraordinarily high dollar commitments in inventories involve risks greater than those which ordinarily have characterized food retailing chains.

(3) In the light of sharply increased pre-tax earnings per employee, the operating expense budget is vulnerable to pressures for higher compensation of personnel.

(4) At the end of 1946, the ratio of current assets to liabilities was the lowest in more than ten years. After deduction of $5 million in notes payable, cash position also was smaller than at any comparable point since 1934.

BASIC POSITION

Among chain organizations in retail food distribution, The Kroger Co. ranks second in the number of stores operated and third in annual dollar sales totals. Formerly under the name of The Kroger Grocery & Baking Company, distribution of grocery lines stems from a single store opened in 1882 in Cincinnati, Ohio. The company's subsequent development into a chain with representation in 18 states has comprised both installation of additional units by the parent organization and, particularly in the later 1920's, absorption of various established store groups. At one point in 1929, as many as 5,588 stores were in operation. Contraction to 2,611 outlets at the end of 1946 has reflected elimination of duplicate locations and substitution of larger outlets of "super-market" type for smaller neighborhood units of service type. Heavily industrialized states bulk large in Kroger's operating territory. Of the 2,611 locations, Ohio alone contained 573 stores, while 454 outlets in Illinois, 314 in Michigan, 289 in Missouri and 264 in Indiana accounted for the major part of the remainder. In the process of consolidating locations, however, the proportion of units operated in such states as Arkansas, Georgia, Kansas and Virginia has increased appreciably.



In addition to standard grocery lines, stores carry fresh fruits and vegetables, bakery items and dairy products. Installation of combination markets dates from 1930 and at the start of the current year, meat departments were included in 1,881 stores. Addition of equipment for handling frozen foods constitutes a more recent development. Disposal of two meat packing plants and a third plant in 1946 has cancelled a wartime expedient for adding to meat supplies. Ap-

plied either in the company's 4 meat warehouses or in the plants of suppliers, a process for tenderizing meats, "Tenderay," continues to be emphasized. Facilities for the preparation of food lines under the company's own brand names include 15 bread and cake bakeries, 2 cracker and cookie bakeries, 5 dairies. 2 coffee roasting plants, 2 beverage bottling plants and a general factory at Cincinnati for preparing a variety of food products. A peanut processing plant in Georgia was acquired in 1941, while extensive testing and food research activities (Kroger Food Foundation) are carried on in Cincinnati.

Totalling $39,321,609 in gross figures and $15,200,726 net after depreciation and obsolescence reserves, property accounts at the end of 1946 covered various service buildings, processing machinery, store equipment and automotive vehicles. Store premises, on the other hand, are held under short term leases with provision for renewals in the majority of cases. Store and other improvements took $4,082,750 in 1946.

CAPITALIZATION—DECEMBER 28, 1946

6% First Non-Cum. Preferred Stock ($100 Par)—Non-Callable	493 shares
7% Second Non-Cum. Preferred Stock ($100 Par)—Non-Callable	407 shares
Common Stock (No Par)	1,836,589 shares

Common Stock listed on the N. Y. Stock Exchange—Symbol KR.

COMMENT: Except for nominal amounts of two preferred stock issues, the capital and earned surplus of The Kroger Co. is represented by common stock. A ranking as of good investment grade is supported further by a record of relatively consistent earnings among food retailing chains.

EARNINGS

Basic operating policies in chain food retailing emphasize realization of maximum volume through competitive pricing and adjustment of handling and selling costs to yield a small percentage profit on total dollar sales.. Against continued contraction in the total number of stores operated, average sales per store increased 272% over the decade ended with 1946. As may be seen in the chart on the preceding page, higher retail food prices have played a major part in recent expansion of dollar sales volumes. At the same time, progress toward substituting self-service combination markets for more numerous small units of service type has been substantial. Compared with 72% at the end of 1946, meat markets had been contained in 62% of 4,212 stores ten years earlier. While tonnage sales of food have shown relatively stable trends from year to year, dollar totals have fluctuated more nearly in line with changes in consumer incomes. Reflecting curtailment in supplies of meats and canned goods, as well as close observance of specified price ceilings, wartime sales of Kroger lagged behind those for food retailing as a whole. More recently, accelerated sales expansion has followed improvement in the supply situation.

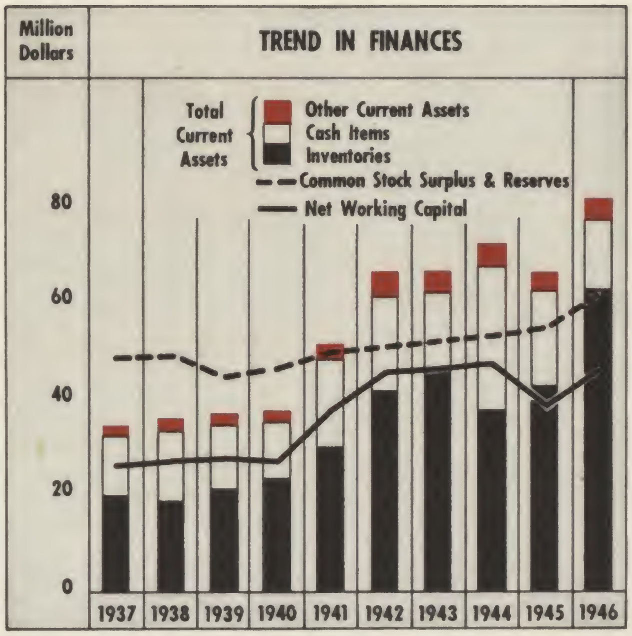
During the war years, ceiling price schedules tended to reduce gross profit percentages for food retailing chains. In Kroger's case, the narrowed margin between wholesale food costs and retail selling prices was translated into a drop in gross profit ratio from 18.95% of sales in 1941 to 15.89% for 1946. In actual figures, however, gross profits increased from $57.4 million to $90.2 million over the same five years. Expansion in sales and gross profits, moreover, outran increases in operating expenses; in relation to year-end employment totals, sales per employee rose from $20,943 for 1942 to $25,392 for 1946. While wartime gains in net operating profits were absorbed by excess profits taxes, net results in 1946 benefited from a combination of further expansion in dollar sales, continued lag in expense increase and reduced taxes.

Years Ended Approx. Dec. 31	No. of Stores	Net Sales	Cost of Sales	Costs % of Sales	Selling, General and Administrative Expenses	Selling etc., Exp. % of Sales	Pre-Tax Earnings	Federal Taxes	Net Income	Per Common Share Earnings	Per Common Share Divd.	Price Range High	Price Range Low
		—Dollar Figures in Thousands—											
1947	—	—	—	—	—	—	—	—	—	—	$1.20†	50*	40¼*
1946	2,611	$567,488	$477,297	84.11%	$66,954	11.80%	$20,933	$8,068	$10,866b	$5.91b	2.50	65½	43¼
1945	2,730	457,333	382,626	83.66	57,577	12.59	15,646	10,002	5,643	3.07	2.00	50⅛	37
1944	2,896	448,381	376,272	83.92	55,492	12.38	14,606	9,462	5,144	2.80	2.00	37½	31½
1943	2,999	422,428	355,084	84.06	53,068	12.56	12,151	7,142	5,009	2.72	2.00	32¾	24⅞
1942	3,174	388,847	322,770	83.01	52,155	13.41	11,426	6,777	4,649	2.53	2.00	29½	22⅛
1941	3,477	302,766	245,380	81.05	46,432	15.34	8,608	1,638	6,970a	3.80a	2.00	29⅞	24
1940	3,727	258,115	206,947	80.18	43,250	16.76	5,707	1,100	4,607	2.51	2.00	34½	23½
1939	3,958	243,357	192,392	79.06	42,303	17.38	6,631	1,116	5,515	3.02	2.50	29⅝	20¼
1938	3,992	231,296	183,234	79.22	41,793	18.07	4,447	706	3,742	2.05	1.90	21⅝	12⅜
1937	4,108	248,444	198,927	80.06	44,481	17.90	3,278	327	2,950	1.62	1.60	24¼	14

*—Through May 12. †—Through June 2. a—After special tax saving of $1,940,000 but before contingency reserve of $2,000,000. b—After provision for employee retirement benefits of $2,000,000 subsequently to be used, but before inventory reserve of $1,500,000.

FINANCES

Over the longer record, Kroger's financial position has been marked by a high ratio of liquid assets to current liabilities. At the end of 1936, total current assets of $35 million were 4.2 times corresponding liabilities, while net working capital amounted to $26.7 million. Turnover rates are characteristically rapid for food inventories, normally affording a satisfactory basis for short term borrowing to meet temporary needs. Increased requirements for working funds accompanied sharp expansion in dollar sales volumes in 1941 and 1942; by the end of the latter year, $14 million in notes payable October 15, 1946 had been assumed and net working capital stood at $45.7 million. Correspondingly, recession in net working funds to $39.3 million at the 1945 year-end followed on anticipation of the maturity date. An increase of 50% in inventory commitments to $63.0 million during 1946 involved contraction in cash holdings from $19.7 million to $14.6 million. Net working capital recovered to $46.3 million, but current liabilities included $5.0 million in notes payable to banks (since reduced) and current assets were 2.3 times corresponding liabilities. Represented principally by net quick assets, book value of the common stock was $33.63 per share at the close of 1946.



OUTLOOK

Compared with the early months of 1946, such basic measures of economic activity as check clearings, manufacturing output and marketings of farm products testify to underlying improvement in Kroger's sales area. On the score of supplies, national production of beef and veal ran 25% greater than for the first quarter of 1946. An increase of 42% in Kroger's sales to $223 million for the first 16 weeks of 1947, however, must be attributed in large part to higher selling prices. By government calculations, wholesale food prices in March stood 52% above their average for the first half of 1946, while retail food prices registered a corresponding increase of 33%. In Kroger's case, retail pricing of meats has been put on a cents-per-pound profit basis in contrast to traditional percentage mark-ups. Gross profit percentages have been reduced, but sales gains in meat departments have led other product categories by wide margins. On an overall basis, moreover, expansion in dollar gross profits has been more than sufficient to offset operating expense increases.

Net results for the first half of 1947 may be expected to show moderate improvement over $2.28 per common share (after $1,500,000 reserve for possible inventory losses) reported for the same period of 1946. Greater uncertainty, however, applies to the outlook for the full year. The contribution of price advances to dollar sales totals likely will diminish as comparisons are made with the high levels reached late in 1946. As dollar sales volume levels off, continued expansion in operating costs may encroach on gross profits, while a sharp drop from the extraordinarily high food prices now prevailing would threaten losses on inventories. Rapid turnover tends to modify inventory risk in food distribution, but merchandise holdings of $63 million at the end of 1946 were about 200% larger than comparable pre-war figures. At the same time, once adjustment of old positions was completed, previous experience has been that wider gross profit percentages were obtained at the lower level of wholesale food prices. Assuming $600 million in net sales for 1947, a pre-tax profit of no more than 2.5% on sales would yield net income approximating $5.00 per common share.

Development Program. Recent emphasis has been on closer integration of operations. In 26 branch headquarters, as well as in the main office, responsibility for both buying and selling has been centered for each of the principal product categories—groceries, meats and fresh produce. Reflecting their better availability, greater selling stress has been laid on national brands; with respect to company-prepared lines, a newly designed "Kroger" label is being substituted for a previous variety of brand names. Compared with depreciation allowances of $23,158,000, gross additions to property account totaled $25,500,000 for the ten years ended with 1946. As building conditions improve, however, an expanded construction program is to be carried out covering new warehouses at four branch points, new bakeries, improvements to other warehouses and modernization of additional retail locations.

JUNE, 1947